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No. 07-586

In The
Supreme Court of the United States

ROBERT S. CUILLO, et al.,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

PETITIONERS' REPLY BRIEF

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PETITIONERS' REPLY BRIEF

A. RARELY HAS THIS COURT FACED SO BROAD, SO IMPORTANT, AND SO LONG NEGLECTED A NEED THAN RESOLUTION OF THE FOUR-WAY CRIME/FRAUD CONFLICT.

The now acknowledged four-way split in the circuits, the tacit admission that the IRS never before posited its recent hypothesis, the radical difference between a timely-identified charge and shadowboxing, and the need for a consistent rule at the finger tips of every practitioner – all cry out for clarity.

1. The Government Concedes the Four-Way Split in the Circuits on this Essential Rule but Misses the Mark as to Its Significance.

If appellate judges splinter this everyday rule into four fractured pieces, what hope can a law student, a CPA, or a lawyer with a rural or national practice harbor? The Government not only misses the mark as to the need for a simple, consistent rule at the fingertips of every aspiring or struggling practitioner. The Government also misses the mark as to the dangerous divide that this case demonstrates.

Fortunately, the Government embraces our position that courts regularly specify both the crime/fraud and ample independent evidence of each of its elements. (Opp. 19-20). Only in that way, can a party marshal a meaningful response to what would otherwise be a vaporous allegation. Contrast that practice, however,

to how the Seventh Circuit's no-identified-wrong rule forces clients to shadow box:

> As we already have noted, ***our case law does not require a party*** seeking to invoke the crime-fraud exception ***to allege a particular offense or to make a prima facie showing*** with respect to each element of common law fraud. Pet. App. 28a (emphasis added).

The Government begs the question about the radical difference between an identified crime/fraud and no identified crime/fraud by resorting to those cases that note the similarity between probable cause, reasonable cause, and *prima facie* proof. (Opp. at 22-23). Those cases that attempt to reconcile the varying standards, however, all reach the exact opposite conclusion embraced by the Seventh Circuit – that is, the party asserting the exception must tender sufficient evidence of the elements that, if believed by the fact finder, would support a finding of crime/fraud. *See, e.g., Haines v. Liggett Group, Inc.*, 975 F.2d 81, 95-6 (3rd Cir. 1992).

This case demonstrates the danger in missing the critical distinction between unidentified and identified charges. Consider the chronology here in judging how easily someone can be scarred for life by a single misinterpreted email.[1]

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[1] With all due respect, the Government's insensitivity to the impact of a reckless crime/fraud allegation by the Government reflects the false comfort of someone who has not yet been falsely accused in a public forum. Footnote 11 of the Opposition drives

- July 29, 2004 – The Clients and their advisors tendered 267 documents for *in camera* review, including the documents the District Court later confirmed reflected profit motive.

- March 30, 1995 – With no identification of any crime/fraud or its elements, the District Court directed the Clients to one sentence in an email which dealt with triggering desired year-end losses. That email also specifically relied upon this Court's precedent in *Cottage Savings Ass'n. v. Commissioner*, 499 U.S. 554 (1991). Nowhere did the District Court (or the Government in its submissions) identify the charge, its elements, or the nature of the District Court's concern.

- April 14, 2005 – The Clients guessed that the Court's concern was the practice of triggering losses at year-end and tendered both affidavits and treatise excerpts relating to that common practice.

- May 15, 2005 – ***After the Clients responded***, the District Court indicated for the first time that it was concerned about "sole purpose" and that the Clients failed to

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home the importance of this point. The Government cavalierly dismisses the impact of an unfounded crime/fraud determination in the face of the harsh lesson the Government forced on the 26,000 employees of Arthur Andersen – it is the allegation that kills first.

> address that concern. Again, the Court failed to identify a crime or fraud, or explain how the email constituted *prima facie* evidence regarding its elements.

Had the Court identified a crime or fraud or even specified its "sole purpose" concern, the Clients could have easily addressed those concerns (as the discussion in the next section confirms). Instead, the Seventh Circuit rule left them guessing.

Practitioners deserve better and the D.C., Third, Fifth, Ninth, and Eleventh Circuits provide more. In these Circuits, not only must a party identify the particular crime or fraud furthered by the communication, he must also present independent evidence as to each element of that identified crime/fraud that, if left unrefuted, would sustain the underlying charge. *See, e.g., In re Sealed Case*, 676 F.2d 793, 815 (D.C. Cir. 1982); *Haines*, 975 F.2d at 95-6; *In re Grand Jury Subpoena*, 419 F.3d 329, 336 (5th Cir. 2005); *United States v. Chen*, 99 F.3d 1495, 1503 (9th Cir. 1996); *In re Grand Jury Investigation*, 842 F.2d 1223, 1226 (11th Cir. 1987). These cases remain true to the Supreme Court precedent over the past 75 years that focuses upon "the charge." *Clark v. United States*, 289 U.S. 1, 15 (1933). Especially when faced with an allegation as destructive as crime/fraud, a citizen must know "the charge" before he or she can hope to offer a meaningful response. And the difference between a meaningful answer and an unwittingly nonresponsive answer invariably dictates different results.

2. The IRS Hypothesis Posited Two Appellate Levels and Three Years After the Required Response Proves the Clients' Point.

For the first time ever in this case, the Government suggests in its Supreme Court Opposition to Certiorari that Document A-40 may evidence a violation of 26 U.S.C. § 7206(2)[2] (aiding in the filing of a false return). (Opp. at 21). Nowhere in any of its many submissions to the District Court did the IRS point to that statute. Nowhere in its three briefs filed with the Seventh Circuit did the IRS cite or even allude to this statute. As a result, the District Court never notified the Clients that they needed to address that charge in their response to the Court's March 30, 2005 Order and the District Court never identified that statute in its post-response Order of May 17, 2005. For the same reason, the United States Court of Appeals for the Seventh Circuit never mentioned it. To this day, neither the Clients, the Government, nor anyone else can say that the District Court ever thought Document A-40 implicated that unidentified statute.[3]

Therein lies the precise problem presented by this case. Had the Government or the District Court

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[2] Unless indicated otherwise, all Section references are to Title 26 of the United States Code – that is, the Internal Revenue Code of 1986 (as amended through December 31, 2001).

[3] The most the Government can say is that the District Court indicated it was concerned about the "sole purpose" implications of Document A-40, but again, the District Court noted that concern for the first time AFTER the required response by the Clients.

pointed to that statute (or identified any other statute or charge), the Clients could easily have addressed that concern. One, the face of Document A-40 itself reflects the author's reliance upon the controlling precedent of this Court in *Cottage Savings Ass'n. v. Commissioner*, 499 U.S. 554 (1991) – precedent that the Government scrupulously avoids citing and that refutes any suggestion of a violation of the law, much less the "willful" commission of a known (not a debatable) violation of the law that Section 7206(2) requires. Ian M. Comisky et al., *Tax Fraud and Evasion* ¶ 2.03[3][d] and ¶ 2.04[1] (6th Ed. 2007). Two, the unaltered factual findings by the trial court in *Cottage Savings* prove the permissible nature of even a "sole purpose" of tax avoidance:

> We agree with respondent [IRS] that the December 31, 1980, transactions were exchanges, and not independent purchases and sales; that these transactions were ***solely tax-motivated and had no business purpose*** other than to secure refunds of previously paid taxes by generating substantial net operating loss carrybacks.... *Cottage Savings v. Commissioner*, 90 T.C. 372, 385 (1988).

Three, the Government also scrupulously avoids the reality that it urged the same "sole purpose" argument in *Frank Lyon*, *UPS*, *Compaq*, and *IES* without ever once equating "sole purpose" with fraud.[4]

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[4] *Frank Lyon Co. v. United States*, 435 U.S. 561, 582-83, (1973); *United Parcel Serv. of Am. v. Commissioner*, 254 F.3d 1014 (11th Cir. 2001); *Compaq Computer Corp. v. Commissioner*, 277 F.3d

Nor does the Government ever acknowledge that this and those three courts ultimately rejected the Government's "sole purpose" characterization. Would the ultimately vindicated tax practitioners giving advice to *Frank Lyon* be guilty of furthering some crime or fraud? What about the tax practitioners in *Cottage Savings*, *Compaq*, *IES*, and *UPS*?

Four, both the documents the Clients knew the District Court reviewed *in camera* and the attachments to the IRS affidavit (Exhibits A-57 and A-62) proved the presence of a profit motive – not to mention that a number of the Clients are still reaping profits from their distressed debt investments. Remarkably, the Government cites Document A-57, the extraordinarily even-handed tax research memorandum in which one tax practitioner noted to another tax practitioner that a potentially adverse interpretation of a tax statute (Section 475) would "render [the investment] useless for our [*i.e.*, the tax practitioners'] purposes." (Opp. at 20). That passage and that memorandum, of course, reflect the tax practitioner's genuine interest in complying with the tax law, unwillingness to violate the tax law, and commitment to obtaining further advice from counsel – the antithesis of fraud. The startling aspect, however, lies in the Government pointing to Document A-57 as proof of sole tax purpose without once mentioning that the very next paragraph in the very same document reflects that even the tax practitioners noted that the distressed debt trader "thinks [the

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778 (5th Cir. 2001); *IES Indus., Inc. v. Commissioner*, 253 F.3d 350 (8th Cir. 2001).

distressed debt packages] will yield very good profits for investors." So too, the Government never mentions the Document A-62 reference by the same tax practitioner to another statement by the same trader that certain distressed debt includes a "kicker" with "a bonus payoff of probably around 12:1."

As a matter of law, another aspect of Section 7206(2) (which the Government also avoids) precludes application of that statute to Document A-40. At the time the tax practitioner authored A-40 relating to "*Cottage Savings*" and even today, the favorable distressed debt treatment in this Court's *Cottage Savings* opinion represents the dominant authority directly on point. As the treatise cited by the Government verifies, both the law and common decency confirm that criminal tax provisions like Section 7206(2) are no place to pioneer new frontiers in the tax law. Comisky, ¶2.03 [3][d]; *United States v. Garber*, 607 F.2d 92, 100 (5th Cir. 1979) (Section 7201 "is an inappropriate vehicle for pioneering interpretations of tax law"); *United States v. Dahlstrom*, 713 F.2d 1423, 1428 (9th Cir. 1983) ("We are convinced that the legality of the tax shelter program advocated by the appellants in this case was completely unsettled by any clearly relevant precedent on the dates alleged in the indictment. 'It is settled that when the law ... is highly debatable, a defendant actually or imputedly lacks the requisite intent to violate it'"); *United States v. Critzer*, 498 F.2d 1160, 1163 (4th Cir. 1974) ("pioneering interpretations of tax law should not be sought or rendered in criminal prosecutions under § 7201, but rather in civil suits"). Not even the IRS published its opposition to these

distressed debt investments until 2007[5] – SIX YEARS AFTER THE CREATION OF A-40. How can a single email constitute *prima facie* evidence of an unidentified crime/fraud as to what was then a debatable but uncontested position supported by favorable Supreme Court authority?

3. Few, If Any, Cases Present a Cleaner Vehicle for Analyzing a Broader, More Important, and Longer-Neglected Principle.

Seventy-five years have passed since this Court last addressed the crime/fraud exception squarely. That is no accident: the everyday rules that practitioners need rarely garner guidance from this Court because they rarely survive a trial on the merits and even more rarely survive an appeal. Because those principles affect all areas of the law, more guidance, not less, is needed. Nonetheless, the Government dismisses these common questions as unwarranted "interlocutory" rulings but equal application of that reasoning would have deprived practitioners of cases such as *Hickman v. Taylor*, 329 U.S. 495 (1946) and so many of the daily tools of justice that affect every area of substantive law. Indeed, 18 out of the 21 privilege cases cited by the Client/Intervenors (including this Court's opinion in *United States v. Zolin*, 491 U.S. 554 (1989)) and 12 of the 14 privilege cases cited by the Government would be excluded by its interlocutory contention. Still,

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[5] *See 2007 IRS Distressed Debt Coordinated Issue Paper*, 2007 WL 1511543 (IRS) (April 18, 2007) cited at both Pet. Br. fn. 6 and Resp. Opp. fn. 3.

the Government seeks to stretch the 75-year void to untold lengths.

Because the now 75 year old *Clark* opinion spoke in broad phrases susceptible to varying constructions, the Courts of Appeal diverged down at least four different paths, some of which run in the parallel directions as the Government notes but at least two of which collide with each other from opposite directions. That collision not only obliterates the ability of any lawyer, law student, or now accountant to state a single consistent rule: it strikes to the fundamental right of every litigant to know the basis for any (reckless) crime/fraud allegation. Indeed, the looser the standard for leveling an unidentified crime/fraud allegation, the greater its function as an improper litigation tactic.

No case presents a cleaner instrument for the much needed statement of a simple straightforward rule – for several of the reasons the Government notes. One, concentration on a single email does more than just highlight how easily anyone's life can be scarred by an unidentified crime/fraud allegation. That one email allows the Court to address the rule with a clarity that would be lost in the face of one thousand documents. Two, that one email better isolates the difference in the litigant's ability to respond to an identified allegation and inability to respond to an unidentified allegation – with the inevitable difference in results. Three, that one email presents a cleaner test for the distinction between *prima facie* evidence of fraud and non-fraud. And four, while the Seventh Circuit's ruling on Document A-40 is final (subject only to this appeal), this Court's experience in *United States v. Arthur Andersen & Co.*, 544 U.S. 696 (2005), demonstrates

how this issue and so much more can be lost by way of unfounded allegations that linger.

B. THE GOVERNMENT AVOIDS THE TWO CRITICAL STATUTORY CONSTRUCTION QUESTIONS PRESENTED BY SECTION 7525(b).

Section 7525(b) presents two statutory construction questions that transcend this case. One, should the title enacted by Congress be considered part of the statute as a whole in construing a statute which yielded opposite "plain meanings" to two different courts in the same case? Contrary to the Government's contention, no one suggests that the Section 7525(b) title limits or controls the plain meaning of the text – only that it sheds light upon text that two courts believe support opposite "plain meanings." Yet, the Government at least implies that the words enacted by Congress in the title to Section 7525(b) should be ignored altogether in construing the statute as a whole. (Opp. at 25-27). A tension exists both within Supreme Court precedent and among the Circuits as to what significance titles carry. *Compare Koons Buick Pontiac GMC, Inc. v. Nigh*, 543 U.S. 50, 60 (2004) ("holistic endeavor"); *Bhd of R.R. Trainmen v. Baltimore & Ohio R.R. Co.*, 331 U.S. 519, 528-9 (1947); *Hardin v. City Title & Escrow Co.*, 797 F.2d 1037, 1039 (D.C. Cir. 1986); *House v. Commissioner*, 453 F.2d 982, 987-8 (5th Cir. 1972); *Griffin v. Steeltek, Inc.*, 160 F.3d 591, 594 (10th Cir. 1998). Particularly now that publishers no longer inject unenacted titles, the confused standing of the part of every modern statute that describes its scope and subject matter needs clarification.

The Government dismisses the second statutory construction question under a logic that, if embraced, would forever deprive it of Supreme Court review. That question focuses upon the ***prospective*** change in the statute that Congress concluded was needed to achieve the construction the Government maintains existed prior to the change. The beauty of a code system of laws lies in the ability of Congress to change an existing statute that needs changing and, especially in the tax world, prescribe whether the change is prospective or retroactive. *Hassett v. Welch*, 303 U.S. 303, 314, 58 S. Ct. 559, 505 (1938) ("[A] law is presumed, in the absence of clear expression to the contrary, to operate prospectively"). *See also*, Section 7805(b) (governing retroactivity of IRS regulations). To ignore the significance of a prospective change (like the 2004 amendment to Section 7525(b)) repeals the "prospective" treatment mandated by statute. Yet, the Government argues that the very existence of a subsequent statutory change renders review of its impact on the pre-amendment construction "unwarranted." (Opp. at 25-27). That logic would necessarily preclude review of this important prospective-amendment construction question because of the existence of the amendment itself. That approach places this question squarely within this Court's doctrine of "capable of repetition, yet evading review." *See, e.g., Moore v. Ogilvie*, 394 U.S. 814, 816 (1969) (appeal of election board candidacy denial held "capable of repetition, yet evading review"); *Southern Pacific Terminal Co. v. Interstate Commerce Commission*, 219 U.S. 498, 515 (1911) (under doctrine of "capable of repetition, yet evading review," ICC orders subject to review despite expiration). Hence, the Government's logic for avoiding review defeats itself.

The first of these two questions touches every modern statute and the second touches every statute Congress chooses to change prospectively. They deserve and need this Court's attention.

CONCLUSION

For all of these reasons, the Petition for Writ of Certiorari should be granted.

Respectfully submitted,

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